McCRORY CORPORATION

ANNUAL REPORT 1966

THIS IS McCRORY:

McCrory Corporation is one of the nation's largest non-food retailing organizations with 1,392 stores coast-to-coast and in Puerto Rico. Its retail operations consist of variety stores, promotional department stores, women's and children's popular fashion stores, auto accessories stores and women's and children's high-quality apparel stores. Retail operations are conducted through three major divisions and two subsidiaries, which are largely autonomous. The corporate home office is responsible for finance, planning, legal, audit and employee benefit programs. McCrory's operations are:

McCRORY-McLELLAN-GREEN
One of the largest and oldest variety store chains. Operates 569 stores. Merchandise includes toys, school supplies, dry goods, hardware, apparel, home furnishings, accessories.

S. KLEIN
Pioneer in the promotional department store field. Operates thirteen stores in the greater New York, Philadelphia and Washington, D.C. environs.

LERNER SHOPS
Largest chain exclusively offering women's and children's apparel. Has 353 stores coast-to-coast and in Puerto Rico. Focus is on latest fashion and quality at popular prices.

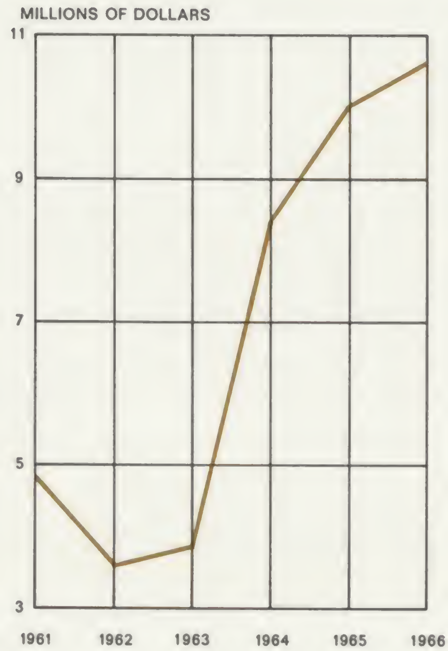
OTASCO-ECONOMY AUTO STORES
Has 442 stores in the south and southwest. Sells auto accessories and parts, appliances, sporting goods and housewares.

BEST & CO.
For nearly 90 years known for elegance in women's and children's apparel. Operates nationally known Fifth Avenue store in New York City and 15 branch stores.

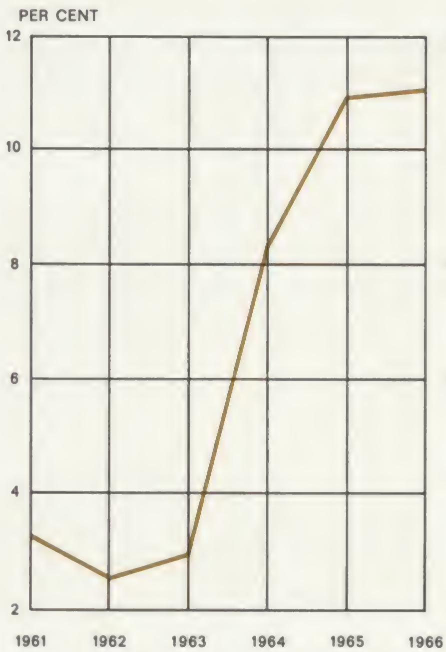
GLEN ALDEN—McCrory owns 49.7 per cent of the common stock of this diversified company. Glen Alden consists of RKO Theatres and textile manufacturing operations. As a result of an acquisition and a merger approved by stockholders on April 12, 1967, Glen Alden will include The B.V.D. Company, Inc., soft goods manufacturer and retailer; and The Philip Carey Manufacturing Company, manufacturer of products for building and industry.

McCRORY CORPORATION

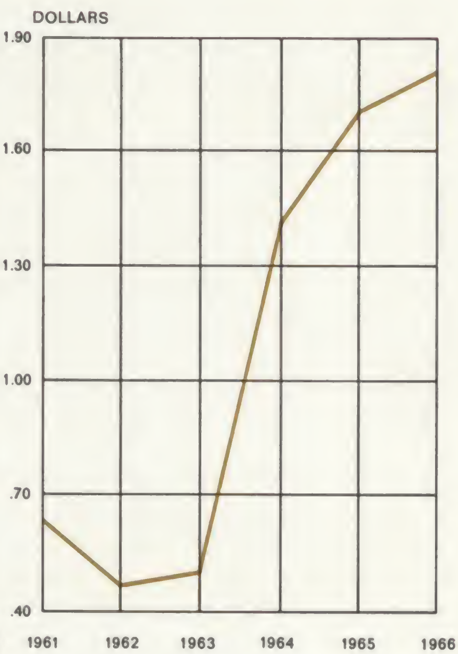
Report to the stockholders for the year ended January 31, 1967



EARNINGS



RETURN ON COMMON EQUITY



EARNINGS PER SHARE

1966 Highlights

- McCrory Corporation's consolidated sales and earnings were highest in its history. After tax earnings reached $10,566,000, equivalent to $1.81 a share. Sales were $712,727,000.
- The McCrory-McLellan-Green (MMG) variety division generated impressive profit gains for the third consecutive year.
- Lerner Shops again set sales and profit records.
- OTASCO-Economy Auto, for the sixth consecutive year, set new records in sales and earnings.
- S. Klein turned the corner and reported a profit for the first time since the year ended July 25, 1964.
- Best & Co. joined the McCrory family of retail companies.

The Annual Meeting of Stockholders will be held at the RKO 23rd St. Theatre, 333 West 23rd Street (between Eighth and Ninth Avenues), New York City, on Tuesday, May 23, 1967, at 10:30 a.m., local time. Each stockholder entitled to vote thereat will receive by mail a formal notice of meeting, together with proxy statement and form of proxy, on or about May 3, 1967, at which time proxies will be solicited by order of the Board of Directors.

To our Stockholders:

We are pleased to report to you that 1966 net earnings were $10,566,000, compared with $10,063,000 in 1965. The 1966 earnings include only 50 per cent of the earnings of Lerner Shops, as compared to virtually all in 1965; 67 per cent of S. Klein's earnings since May 1, 1966; and all of Best & Co.'s earnings from October 14, 1966.

Sales in 1966 were $712,727,000, compared with $513,229,000 in 1965. Sales for 1966 include, for the first time, the sales of S. Klein since May 1, 1966 and those of Best & Co. since October 14, 1966.

Depreciation and amortization charges in 1966 amounted to $9,725,000. Cash generated (defined as net income, depreciation, amortization and deferred Federal income taxes) totaled $24,806,000, equal to $4.77 per common share, compared with $25,190,000, or $4.84 per common share in 1965.

Results of Divisional Operations

All our operations were profitable in 1966 and all posted gains over the year before. In order that you may be acquainted with the relative size and scope of operations of McCrory's components, we are providing our divisions' and subsidiaries' sales and earnings. When analyzing the contributions by these operations to our consolidated results, please keep in mind that the figures of operations do not reflect our corporate home office expenses, deductions and certain income. These expenses include interest payments on our short and long term debt, corporate executive salaries, legal and auditing fees and other expenses. Other income consists principally of dividends on investments and earnings of McCrory Credit Corporation.

MMG achieved *pretax earnings* of approximately $10,553,000, a 13 per cent increase over earnings last year of $9,283,000. Sales in 1966 were $238,406,000, compared with $240,447,000 in 1965.

OTASCO-Economy Auto *pretax earnings* were $5,229,000 in 1966, compared with $4,411,000 for the prior year. Sales in 1966 were $65,294,000, compared with $58,101,000 last year.

McCrory's equity in the net income of S. Klein for the nine months ended January 31, 1967 amounted to $1,415,000. S. Klein reported net sales of $166,018,000 for this period.

Lerner Shops earned $11,085,000 *before taxes* and $6,735,000 after taxes in 1966, compared with $10,005,000 *before taxes* and $6,105,000 after taxes in 1965. Sales in 1966 were $227,760,000, compared with $212,165,000 last year.

On October 14, 1966, McCrory acquired the business and operating assets of 16 Best & Co. stores, including its nationally known New York City store on Fifth Avenue at 51st Street. Best & Co. is one of the nation's best known high-quality women's and children's apparel retailers. We have high hopes for Best & Co. under the McCrory banner.

During the past year, McCrory Corporation invested $12,295,000 in capital expenditures to establish 60 new stores, improve 87 existing stores, and provide the distribution and other facilities to service our retail units.

Three Presidents took office during 1966: Lorence A. Silverberg at MMG; R. Duffy Lewis at S. Klein, and Jack Schwadron at Best & Co.

Tender Offer

Under a plan approved at a special stockholders meeting on February 14, 1967, McCrory exchanged approximately $12,000,000 principal amount of 6½ per cent Convertible Subordinated Debentures, plus cash of $2,875,000 where applicable, for certain of its securities. The results of this offer, which expired April 10, 1967, are set forth on page 16 under "Events subsequent to January 31, 1967".

Employee Scholarship Program

The first group of 39 college scholarship winners, sons and daughters of McCrory employees, now are completing their freshman year. The significance of our company scholarships to these talented youngsters and their families is described in terms of the experience of one award winner on page 8.

Observations

We would like to thank our Board of Directors, officers and employees for their help and loyalty during the

past year. We also would like to thank our many suppliers, and our friends at our banking institutions.

We are proud of our progress in 1966. Not only have we made substantial financial gains, but we have continued to build a unified and energetic team throughout our organization. We look forward to further progress in 1967.

Sincerely,

Meshulam Riklis
Chairman of the Board

Samuel Neaman
President

April 20, 1967

FINANCIAL HIGHLIGHTS

	1966	1965	1964
Net sales	$712,727,000	$513,229,000	$547,433,000
Net earnings	10,566,000	10,063,000	8,666,000
Return on common equity	11.0%	10.9%	8.3%
Net earnings per share	$1.81	$1.70	$1.41
Cash dividends per share	1.20	1.20	.80

STORE INFORMATION

	MMG	OTASCO	LERNER	KLEIN	BEST	TOTAL
Stores in operation as of January 31, 1967	569	442	353	12	16	1,392
Stores opened during 1966	20	26	12	2	—	60
Stores closed during 1966	17	3	2	—	—	22
Stores remodeled during 1966	57	12	18	—	—	87
Stores expected to open in 1967	25	12	13	1	—	51

McCRORY-McLELLAN-GREEN

McCrory-McLellan-Green

MMG's continuing success is a testimonial to the ability of its people to respond to challenge under the outstanding leadership of Samuel Neaman.

The overwhelming majority of present employees were with MMG when the division failed to realize its potential and turned in a very unsatisfactory performance in 1963. This same group was the backbone of the improved $7 million pretax earnings in 1964, the $9 million pretax earnings in 1965 and $10.5 million pretax earnings last year.

What made the difference? Motivation coupled with the benefits of new, modern retailing tools is the answer.

Career opportunity was one ingredient which improved employee motivation. MMG has increased the number of new jobs open to ambitious, capable people. It has instituted training programs to qualify both newcomers and veterans for these positions, which range from store sales supervisors to District Managers.

Improved salary and benefits further stimulated employee motivation. MMG employees and executives have had several salary improvements in the past two years. Employee benefits now include retirement income, life insurance, disability income, medical-hospital insurance, employee discounts and the McCrory College Scholarship Program for children of employees. *The division today is one of the industry leaders in wages and benefits.*

MMG's personnel have contributed a total of 66,000 years of service. In 1966, 5,420 employee length of service awards were made.

Programs for recognition of unusual achievement have been developed. Seventy-six manager awards recognizing outstanding sales, profits, payroll control and other criteria were made at the district level, as well as ten regional and two national awards.

Last year the MMG headquarters was relocated from Manhattan to York, Pa. where the division's main distribution center is located. It is expected that important efficiencies and economies will result from this move.

Accounting and merchandise control techniques were improved in 1966, making possible faster inventory turnover and a quicker flow of information for management decisions.

McCrory-McLellan-Green manager shows store employees how to stock shelves for best customer response. Division has developed many new merchandising methods.

S. KLEIN

S. Klein

This 63-year old pioneer in the promotional department store field took a new lease on life when it opened a new four-level, 170,000 square foot store in Flushing in February, 1967. This was the first new store the organization opened in New York City in 60 years and was made possible by an agreement reached with the estate of Samuel Klein for the opening of new S. Klein stores within the city.

The key to the success of this new operation and the seven others that are planned for the next 30 months is service. S. Klein management is convinced that the average customer is tired of gray, cheerless barns that have characterized promotional department stores. Customers want service, useful product information and cheerful surroundings.

Salesman at S. Klein's new Flushing, New York store explains fine points of sports jacket to shopper. Personnel are trained to know their merchandise.

The merchandise selection in the new and older S. Klein stores is now based on providing something for nearly every kind of customer, with unusual value at various price levels. Another change in operations is to divide the stores into virtually separate shops, with sales people assigned to specific shops. This innovation has encouraged sales personnel to know their merchandise better and has provided them with incentive to make their respective "shops" excel.

The new S. Klein merchandising program has required the building of a strong, centralized management, with experienced specialists holding down all key functions—from advertising to quality control. Careful selection and training of sales personnel is practiced. Salaries have been raised and new employee benefits have been added. A number of young executives have been promoted and some experienced people have been brought in from MMG and other McCrory operations and a number of leading specialists have joined S. Klein from outside companies.

Management believes that the improved results in 1966 at S. Klein are only the beginning of a new period of growth for this operation. Plans call for the doubling of S. Klein sales in the next four or five years through the opening of new stores and the growth of existing operations.

McCrory Corporation plans to renew its exchange offer for common stock and convertible debentures of S. Klein in the near future. The exchange will be made under the same terms as in the previous offer.

OTASCO-ECONOMY AUTO; LERNER SHOPS

OTASCO-Economy Auto

The ability of OTASCO-Economy Auto to set new growth records for the past six years can be credited to its continuing desire to improve.

Last year new emphasis was placed on improving the selection, quality and value of the division's merchandise. To achieve this, the buying staff was expanded. Special steps were taken to enhance private brand lines which tend to give extra benefits to customers and exclusive merchandising advantages to OTASCO-Economy Auto.

A special advertising and promotional campaign was started personalizing "YOUR OTASCO MAN" and "YOUR ECONOMY AUTO MAN." The campaign highlights the division's genuine interest in its customers and gives new attention to major merchandise lines where the division has unique competitive strength.

Recruiting and training of personnel were accelerated during the year and additional investments were made in better distribution facilities, data processing equipment, retail auto service installations and a variety of other up-to-date retailing facilities.

While the new and remodeled store program of OTASCO-Economy Auto is mentioned on page 3, it might be interesting to point out here that the division opened its fourth combination "auto-variety" store in 1966. This type of store offers customers both auto and variety products. The new store and the three older combination units have enjoyed excellent sales and profits.

Lerner Shops

For nearly half a century, Lerner Shops has presented to American women and children the last word in fashion at the lowest possible price. Its experienced buyers are constantly in search of designs found in higher-priced fashions that can be offered to customers at popular-to-medium prices. It takes great taste and talent to spot the beginnings of a fashion trend, interpret it in terms of established high standards of quality, and then offer it to customers at reasonable prices.

To support growing customer acceptance of Lerner Shops' merchandising principles, two important expansion projects were launched during the past year.

The first of these was a new combination home office and distribution center. Since 1927 the Lerner Shops home office and main distribution center have been located in a 20-story building on Park Avenue South in New York City. It became increasingly apparent in recent years that this building did not lend itself to modern automation and other effective operations needed to keep pace with the company's progress.

In 1966 a commitment was made to occupy four floors of the new Mid-town Mart, now under construction

Features of grass cutting tractor are described by salesman at OTASCO-Economy Auto store. Division expanded its lines of merchandise in 1966.

Lerner Shops' employee beams approval of customer's choice of hat.

BEST & CO.; GLEN ALDEN CORPORATION

on Manhattan's west side, a location close to major merchandise suppliers. Lerner Shops will have its own private entrance and lobby, its own passenger elevators, and its own specially designed facilities for moving merchandise from the ground floor receiving area to operating floors. Occupancy is planned for the latter part of 1968 or early 1969.

A second important step taken during the year was to start construction of a new regional office and distribution center in Pittsburgh. Regional headquarters already exist in Atlanta, Denver, Chicago, Los Angeles and Jacksonville. The six regional installations are expected to handle 60 per cent of Lerner Shops annual sales volume.

Best & Co.

Best & Co. is one of the smartest, most renowned of Fifth Avenue's fashion shops. Adding its luster to the ever-growing family of companies under the McCrory banner, this fine store is reflecting today's accent on youth in many ways.

Best & Co. is encouraging new, exciting designers whose wares appeal to young career girls and other fashion-aware customers. While the classics hold an important place in the store's merchandising plans, there is the additional excitement of today's young, young fashions. This new youth-oriented outlook is attracting some of the most talented retail personnel in the city—young men and women who will add their enthusiasm to the experience and knowledge of Best & Co.'s present loyal staff.

In addition to merchandise changes, there are many physical changes planned for the near future, changes that mirror the most modern retailing and management techniques—new improved floor layouts, additional selling space and a bright, new face-lifting. Best & Co.'s traditions of good taste, meticulous service and high quality will be maintained and, of course, the Liliputian Bazaar, famous for children's apparel, will continue to be one of the most important floors in the store.

Glen Alden Corporation

Glen Alden in 1966 achieved net income of $6,464,000, including $234,000 of extraordinary items. In 1965 net income was $3,313,000 after extraordinary losses (principally in the sale of the coal division) of $3,213,000. Operating income in 1966 was $4,609,000, compared with $3,865,000 in 1965, excluding operations discontinued in 1965.

Shareholders of Glen Alden Corporation, The Philip Carey Manufacturing Company and The B.V.D. Company, Inc. met at separate meetings on April 12, 1967 and approved Glen Alden's merger with Philip Carey and its acquisition of B.V.D.

Young patron wears latest spring coat from Liliputian Bazaar of Best & Co.

GLEN ALDEN HIGHLIGHTS

	1966	1965
Net sales and revenues	$53,797,000	$79,171,000
Income before extraordinary items	6,230,000	6,526,000
Extraordinary items net	234,000	(3,213,000)
Net income	6,464,000	3,313,000
Working capital	35,417,000	46,665,000
Current ratio	4.4 to 1	7.9 to 1
Shareholders' equity:		
Total	69,981,000	68,620,000
Per share	$14.58	$14.28

McCRORY COLLEGE SCHOLARSHIP PROGRAM

McCrory College Scholarship Program

Carol Prince is a 1966, $1,000 per year, four-year scholarship winner. She is completing her freshman year at Indiana University of Pennsylvania where she will major in English.

Carol's mother, Catherine, is office cashier at the MMG Store in Somerset, Pa. Her father, Charles, is a wholesale gasoline salesman. Mr. and Mrs. Prince did not go to college but they wanted Carol and her two younger brothers to enjoy higher education.

"Youngsters who do not go to college will miss a great deal of what the future may offer," Mrs. Prince said. "We want our children to have a good start in life. That is why both of us work and why we have a saving program."

Carol showed her college potential from the earliest elementary grades. Quick and alert, she was encouraged by her teachers. In high school, she was elected to the National Honor Society, served as Editor-in-Chief of her school newspaper and was a member of "Quill & Scroll," the journalistic honor society.

The McCrory scholarship has made it possible for Carol to go to college free of financial worry.

Carol loves her life at the campus of this small, liberal arts coeducational institution in the rolling green hills of western Pennsylvania. She commutes home on weekends to help with family chores and renew hometown friendships.

She plans to become a teacher when she graduates and offer other youngsters the guidance and encouragement she received.

Under the McCrory Scholarship Program, inaugurated in 1966, a minimum of 20 four-year scholarships are awarded to children of employees, up to a maximum of $1,000 a year per scholarship, for a total of $20,000 yearly. Awards are geared to academic achievement and financial need. McCrory's purpose is to benefit its employees by assisting in the educational goals of their children. By 1969 and thereafter McCrory will be sponsoring a minimum of 80 scholarship students yearly, at an annual contribution of $80,000.

Carol Prince, a 1966 McCrory scholarship winner, studies zoology lesson.

Carol's mother is cashier at MMG store.

Carol on weekend visit with family.

OFFICERS OF McCRORY'S OPERATING UNITS

McCRORY-McLELLAN-GREEN STORES OFFICERS

YORK, PA.

L. A. Silverberg .... *President*
J. F. King .... *Senior Vice President*
E. B. Hood .... *Vice President*
N. W. Embley .... *Vice President*
C. Gass .... *Vice President*
R. A. Elliott .... *Vice President*
C. O. Murphree .... *Vice President*
P. McClellan .... *Vice President*
H. R. Hughes .... *Vice President*
J. M. Chernow .... *Vice President*
K. E. Phillips .... *Vice President*

NEW YORK, N. Y.

L. C. Shockley .... *Assistant to the President*
W. Shuldiner .... *Vice President*
R. O. Kristiansen .... *Vice President*

FIELD

B. Litwak .... *Vice President*
C. F. Carter, Jr. .... *Vice President*
T. B. Acker .... *Vice President*
O. W. Wheeler .... *Vice President*
N. P. McLuckie .... *Vice President*
N. S. McBrayer .... *Vice President*

OTASCO-ECONOMY AUTO STORES OFFICERS

Maurice Sanditen .... *Chairman*
Julius Sanditen .... *President*
Abe Brand .... *Executive Vice President*
Ely Sanditen .... *Senior Vice President*
Edgar R. Sanditen .... *Vice President*
A. A. McNatt .... *Vice President*
John R. Behl .... *Vice President*
Edward Wilkonson .... *Vice President*
Samuel H. Minsky .... *Secretary*
Herman Sanditen .... *Treasurer*

LERNER STORES CORPORATION OFFICERS

Harold M. Lane, Sr. .... *Chairman of Executive Committee & Chief Executive Officer*
Stanley H. Kunsberg .... *Chairman of the Board*
Harold M. Lane, Jr. .... *President*
Harold F. Miller .... *Executive Vice President & Secretary*
D. John Palladino .... *Vice President & Treasurer*
Karl Margolis .... *Vice President*
Nathan B. Epstein .... *Vice President*
Eugene D. Frank .... *Vice President*
Milton Seegal .... *Vice President*
Robert L. Krill .... *Vice President*
Harold Greene .... *Vice President*
Eugene Shaw .... *Vice President*
Melvin J. Redmond .... *Vice President*
David D. Greenwald .... *Vice President*
Abraham D. Sperber .... *Vice President*
Bruce A. Jacobi .... *Vice President*
Samuel S. Brand .... *Vice President*
Max J. Miller .... *Vice President*
Jacob J. Scher .... *Vice President*

S. KLEIN DEPARTMENT STORES, INC. OFFICERS

Samuel Neaman .... *Chairman of the Board & Chief Executive Officer*
R. Duffy Lewis .... *President*
Stanley Maer .... *Vice President*
David Portnoy .... *Vice President*
Joseph Walker .... *Vice President & Secretary*
Hyman Leder .... *Vice President*

BEST & CO. OFFICERS

Jack Schwadron .... *President*
Ronald Ruskin .... *Vice President*

McCRORY CORPORATION
AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEET

	January 31, 1967	January 31, 1966
Assets		
Current Assets:		
Cash and, in 1967, U. S. Treasury Bills	$ 5,155,312	$ 14,669,252
Receivables after allowance for doubtful accounts	18,496,714	4,689,848
Merchandise inventories, at lower of cost (mainly retail method) or market	108,251,365	79,080,220
Prepaid expenses, etc.	3,916,043	1,994,820
Total Current Assets	135,819,434	100,434,140
Investments in and Advances to:		
Glen Alden, at cost	34,267,491	34,267,491
S. Klein Department Stores, Inc., at cost		3,419,178
McCrory Credit Corporation, at equity	6,625,568	6,305,793
	40,893,059	43,992,462
Property and Equipment, at cost	173,145,430	150,539,572
Less accumulated depreciation and amortization	95,389,913	83,877,375
	77,755,517	66,662,197
Other Assets:		
Excess of cost of investments in subsidiaries over related equities	16,149,623	8,632,938
Unamortized debt expense	5,988,375	6,664,312
Mortgages and sundry	3,903,587	4,557,845
Trademarks, deferred charges and unamortized goodwill	4,241,171	2,518,115
	30,282,756	22,373,210
	$284,750,766	$233,462,009

See Notes to Financial Statements.

Liabilities and Stockholders' Equity	January 31, 1967	January 31, 1966
Current Liabilities:		
Notes payable to banks	$ 8,500,000	
Current maturities of long-term debt	13,815,219	$ 6,365,922
Accounts payable	26,639,064	18,105,023
Accrued expenses and sundry	21,392,206	17,727,121
Accrued Federal income taxes	7,576,792	4,845,697
Total Current Liabilities	77,923,281	47,043,763
Long-Term Debt, less current maturities	59,555,412	53,756,308
Deferred Federal Income Taxes and Other	19,211,035	15,168,200
Minority Interest in Subsidiary Companies	20,077,101	13,811,129
Stockholders' Equity:		
Preferred and preference stocks	21,944,400	22,463,000
Common stock, $.50 par value, authorized 15,000,000 shares; issued 6,099,263 shares and 6,075,467 shares	3,049,632	3,037,733
Capital surplus	43,338,279	41,280,363
Earned surplus	57,383,383	54,322,890
	125,715,694	121,103,986
Less treasury common stock 889,551 shares and 873,068 shares, at cost	17,731,757	17,421,377
Stockholders' Equity	107,983,937	103,682,609
	$284,750,766	$233,462,009

See Notes to Financial Statements.

McCRORY CORPORATION
AND SUBSIDIARY COMPANIES

STATEMENT OF CONSOLIDATED INCOME

	Year Ended January 31, 1967	Year Ended January 31, 1966
Revenues:		
Net sales	$712,726,688	$513,228,658
Other—net	3,681,273	3,300,931
	716,407,961	516,529,589
Costs and Expenses:		
Cost of goods sold	524,054,481	364,469,561
Selling, general and administrative expenses	151,174,276	120,100,671
Interest and debt expense	8,927,963	7,712,348
Depreciation and amortization	8,845,931	8,079,626
Federal income taxes	8,740,000	6,180,000
	701,742,651	506,542,206
Income Before Minority Interest	14,665,310	9,987,383
Income Applicable to Minority Interest	4,099,502	(75,847)
Net Income	$ 10,565,808	$ 10,063,230
Net Income per Share of Common Stock	$1.81	$1.70

See Notes to Financial Statements.

STATEMENT OF CONSOLIDATED SURPLUS

	Year Ended January 31, 1967	1966
Earned		
Balance, February 1	$54,322,890	$61,438,766
Add (Deduct):		
Net income	10,565,808	10,063,230
Dividends:		
On preferred and preference stocks	(1,141,586)	(1,217,387)
On common stock:		
Cash ($1.20 per share)	(6,238,054)	(6,291,603)
In kind—524,923 shares of Lerner Stores Corporation common stock		(4,551,249)
Excess of cost of shares of treasury stock issued under stock option plans over option price	(97,842)	(2,789,868)
Provision for estimated losses principally in connection with closing of certain Lanes Department Stores, net of estimated Federal income tax benefit		(2,500,000)
Gain on sale of 1,974,088 shares of Lerner Stores Corporation common stock		219,441
Other—net	(27,833)	(48,440)
Balance, January 31	$57,383,383	$54,322,890
Capital		
Balance, February 1	$41,280,363	$39,098,719
Add:		
Excess par value resulting from conversion of preferred and preference stocks into common stock	504,330	2,092,907
Excess of proceeds over par value of common stock issued on exercise of Warrants	7,508	84,103
Surplus arising from issuance of 772,339 Warrants in Klein acquisition at $2 per Warrant	1,544,678	
Other—net	1,400	4,634
Balance, January 31	$43,338,279	$41,280,363

See Notes to Financial Statements.

McCRORY CORPORATION
AND SUBSIDIARY COMPANIES

SOURCE AND APPLICATION OF CONSOLIDATED FINANCIAL RESOURCES

	Year Ended January 31, 1967	Year Ended January 31, 1966
Source		
Operations:		
Net income	$10,565,808	$10,063,230
Charges not requiring current outlays:		
Depreciation and amortization, including debt expense	9,725,294	8,946,322
Deferred Federal income taxes	4,515,000	6,180,000
	24,806,102	25,189,552
Increase in long-term debt	5,799,104	
Sale of Lerner Stores Corporation common stock		16,796,819
	$30,605,206	$41,986,371
Application		
Additions to property and equipment, net	$12,294,938	$ 3,077,673
Dividends paid	7,379,640	7,508,990
Charges to reserve for closing of loss stores	1,029,121	2,774,451
Reduction in long-term debt		12,570,549
Treasury stock purchased (net of stock option sales)		5,693,337
Investment in S. Klein Department Stores, Inc.		3,419,178
Other—net	5,395,731	2,974,154
Increase in working capital	4,505,776	3,968,039
	$30,605,206	$41,986,371

See Notes to Financial Statements.

ACCOUNTANTS' OPINION

McCrory Corporation:

We have examined the financial statements of McCrory Corporation and subsidiary companies except Lerner Stores Corporation and its subsidiaries for the year ended January 31, 1967. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. As to Lerner Stores Corporation and its subsidiaries, we were furnished with the report of other accountants on their examination of the financial statements of that company and its subsidiaries for the year.

In our opinion, based on our examination and the report of other accountants referred to above, the accompanying consolidated balance sheet and statements of consolidated income, surplus and source and application of consolidated financial resources present fairly the financial position of McCrory Corporation and subsidiary companies at January 31, 1967 and the results of their operations and the source and application of their consolidated financial resources for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

HASKINS & SELLS
Certified Public Accountants

New York, N. Y.
April 5, 1967 (except for information in the last Note to Financial Statements which is as of April 10, 1967).

NOTES TO FINANCIAL STATEMENTS, JANUARY 31, 1967

Principles of consolidation

The consolidated financial statements include Lerner Stores Corporation (50.1% owned), S. Klein Department Stores, Inc. (67.1% owned), and all wholly-owned subsidiaries except McCrory Credit Corporation and Glen Alden-Delaware, Inc. The majority ownership of Klein was completed late in April 1966; its net sales ($166,017,875) and McCrory's equity in its net income ($1,415,127) for the nine months ended January 31, 1967 are included in the statement of consolidated income. On October 14, 1966 McCrory acquired the principal operating assets and business of Best & Co., Inc.

McCrory Credit Corporation and equity in instalment accounts sold

McCrory and its affiliates assign certain customers' accounts receivable to McCrory Credit Corporation, which remits 90% of the amount thereof. The companies accept reassignment of any accounts in default, as defined. The 10% equity of McCrory and subsidiaries in assigned accounts (the uncollected balances of which amount to $31,248,000 at January 31, 1967) is included in receivables in the consolidated balance sheet. Collections in January 1967 (payable to McCrory Credit Corporation in February 1967) from assigned customers' accounts (net of 10% equity) amounting to $8,379,000 have been deducted from receivables in the consolidated balance sheet. The investment in McCrory Credit Corporation is carried at McCrory's equity in the capital and undistributed earnings at January 31, 1967 as summarized below:

Accounts receivable, less unearned discount	$38,586,258	
Other assets, less other liabilities	5,389,310	$43,975,568
Notes payable to banks	35,350,000	
Notes payable to McCrory and subsidiaries ($2,000,000 current)	6,000,000	41,350,000
McCrory's equity		$ 2,625,568

Net income of McCrory Credit Corporation for the years ended January 31, 1967 and 1966 of $319,775 and $387,265, respectively, is included in consolidated income.

Investments

CONSOLIDATED SUBSIDIARIES:

Lerner Stores Corporation—McCrory owned at January 31, 1967 and 1966 a majority (2,558,815 and 2,555,457 shares, respectively) of Lerner common stock.

S. Klein Department Stores, Inc.—McCrory owned at January 31, 1967, 805,077 shares (67.1%) of Klein common stock and $1,836,000 principal amount (55%) of Klein 5¾% convertible subordinated debentures. The shares, except for 225,518 acquired for cash during 1965, and debentures were acquired during March and April 1966 in exchange for $7,723,390 principal amount of McCrory 5% junior sinking fund debentures, due 1981, and 772,339 common stock purchase warrants.

At January 31, 1967 the aggregate cost of investments exceeded equity in underlying net assets at dates of acquisition as follows: common stock of Lerner ($8,650,000) and securities of Klein ($7,499,623). Such excess purchase costs have been recognized by the McCrory management to be similar in nature to intangibles which have not declined in value since acquisition. Accordingly, at dates of acquisition, management adopted the policy of not amortizing these excess purchase costs, so long as there is no recognized diminution in value of the related investments.

GLEN ALDEN:

On July 26, 1966 McCrory exchanged 2,388,230 common shares (49.7%) of Glen Alden Corporation for 2,388,230 shares of common stock (100%) of Glen Alden-Delaware, Inc. Upon consummation of the merger of Glen Alden Corporation and Glen Alden-Delaware, Inc. McCrory will receive 2,388,230 shares (initially representing 49.7%) of the outstanding common stock of the new Glen Alden Corporation.

Long-term debt

Long-term debt at January 31, 1967 and maturities due within one year consisted of the following:

	Current Maturities	Long-Term Debt
5½% sinking fund subordinated debentures, due 1976 (a)		$36,040,960
5.235% subordinated notes, due in equal annual instalments to 1969	$ 1,786,284	3,572,569
5% junior subordinated notes, maturing serially to April 1, 1970	3,582,345	2,985,287
5% junior sinking fund subordinated debentures, due July 15, 1981 (b)		7,723,390
5.70% promissory note, due serially to September 1, 1969 (c)	1,000,000	4,400,000
5¾% convertible subordinated debentures, due in annual instalments from 1970 to 1979 (d)		1,507,000
6% notes	4,000,000	142,017
3% sinking fund debentures, due July 1, 1967	2,582,000	
Sundry, principally mortgages	864,590	3,184,189
Total	$13,815,219	$59,555,412

(a) Exclusive of $831,104 redeemed and cancelled which is available for 1968 sinking fund payment. Sinking fund requirements in each year are as follows: 1968 through 1971—$2,048,448; 1972 through 1976— $3,277,517, with a final payment of $12,290,687 due on August 15, 1976.

(b) Required annual sinking fund payments commencing January 30, 1970 are 2% of the aggregate principal amount outstanding on the preceding January 15. Such payments at the 2% rate continue each succeeding year to and including 1974 and at the rate of 5% with respect to each year thereafter to January 30, 1980.

(c) Payable in instalments of $1,000,000 on September 1, 1967 and 1968 plus contingent prepayments in an amount equal to 50% of the Klein consolidated net earnings (as defined) with the balance ($3,400,000 reduced by such contingent prepayments) payable on September 1, 1969.

(d) Sinking fund requirements are $350,000 principal amount annually beginning June 1, 1970. Converted debentures in the amount of $157,000 are available for the 1970 sinking fund payment. The debentures are convertible into Klein common shares at the rate of $9.42 per share, subject to adjustments in certain events.

The aggregate of long-term debt maturing during the five years ending January 31, 1972 is approximately as follows: 1968, $13,815,000 (included in current liabilities); 1969, $6,822,000; 1970, $9,636,000; 1971, $3,060,000; and 1972, $3,874,000.

Agreements covering certain indebtedness of McCrory contain covenants concerning working capital position, additional indebtedness, limitations on the declaration and payment of dividends, restrictions on transactions in capital stock, etc. At January 31, 1967 approximately $22,764,000 of consolidated surplus was free of restrictions.

Federal income taxes

For Federal income tax purposes accelerated methods of computing depreciation and the instalment method of reporting certain sales have been availed of. The use of these methods has resulted in tax deferrals which have been charged against income and credited to deferred Federal income taxes. McCrory (including wholly-owned subsidiaries) has an unused investment tax credit of approximately $1,250,000 at January 31, 1967.

As a result of the examination of the income tax returns of Klein and its subsidiaries for the fiscal years ended July 27,

1957 and July 26, 1958, the Internal Revenue Service has asserted income tax deficiencies, by reallocating the net incomes of certain of its subsidiaries to Klein and, in the alternative, by disallowing the surtax exemptions of most such subsidiaries. Klein does not agree with the asserted deficiencies (which aggregate approximately $358,000) and has petitioned the Tax Court for review. Counsel for Klein have advised that they cannot at this time express an opinion as to how much, if any, additional tax liability may result in respect of such asserted deficiencies. The same issue may be presented for subsequent fiscal years through July 29, 1962. Payment, if any, of the tax deficiencies will not be charged to net income but will be charged to surplus by Klein and will result in adjustment of the excess of cost of investments and minority interest by McCrory.

Reserve for the closing or sale of loss stores

During the two years ended January 31, 1966 McCrory's Board of Directors established a reserve for losses principally inherent, although not yet realized, in planned closing or sale of loss stores and discontinuance of credit service at certain stores. In the years ended January 31, 1967 and 1966 charges totaling $1,029,121 and $2,774,451, respectively, net of Federal income taxes, were made to this reserve.

Preferred and preference stock and common stock purchase warrants

At January 31, 1967, 219,444 shares of $100 par value preferred and preference stock were outstanding (aggregate par value $21,944,400; aggregate redemption amount $23,382,851) and 360,443 shares of common stock were reserved for the conversion thereof, as follows:

Class of Stock	Shares Authorized	Shares Outstanding	Redemption Price	Conversion Rate	Common Shares Reserved
3½% cumulative convertible preferred	24,394	4,394	$104	5 for 1	21,970
$6 cumulative convertible preference	95,695	94,725	115	3/14 for 1	20,298
5½% cumulative subordinated preference B	5,682	5,682	100	5 5/9 for 1	31,567
4½% cumulative subordinated preference B	119,843	114,643	100	2 1/2 for 1	286,608
Total		219,444			360,443

At January 31, 1967 there were outstanding 449,641 Warrants (expiring March 15, 1976) and 2,986,955 Warrants (expiring March 15, 1981) to purchase McCrory common stock at $20 per share through March 15, 1976, and at $22.50 per share through March 15, 1981.

Stock option and employee stock purchase plans

Shares of McCrory's common stock reserved for issuance under stock option and employee stock purchase plans are tabulated below:

	1960 and 1961 Plans	1964 Plan	Employee Stock Purchase Plans
Option price range	$12.25–$21.50	$13.125–$20.125	$10.63–$14.24
Shares			
Outstanding February 1, 1966	124,650	416,136	2,829
Transactions during year ended January 31, 1967:			
Granted	—	60,000	—
Exercised	—	(12,784)	(1,466)
Cancelled, etc.	(3,700)	(25,600)	(184)
Outstanding January 31, 1967	120,950	437,752	1,179
At January 31, 1967:			
Exercisable	71,715	232,950	1,179
Available for grant	None	177,150	None

During the year ended January 31, 1967 options for 14,250 shares were exercised at an aggregate option price of $188,369. On February 13, 1967 McCrory's Board of Directors adopted, subject to stockholder approval, a qualified stock option plan for 200,000 shares of common stock.

Pension plans

Contributions of $1,258,000 and $1,170,000, respectively, for the years ended January 31, 1967 and 1966, made under noncontributory retirement and profit sharing plans, principally for employees of Otasco Division and Lerner, have been reflected in the statement of consolidated income. Under the noncontributory retirement plan covering eligible employees of the MMG Division, the cost of the plan will be met, as required, by periodic contributions to the trust fund. The amounts accumulated in the trust fund in respect of such plan exceed the actuarial liability as computed by the consulting actuary. For this reason, no provision for costs under this plan has been reflected in the statements of consolidated income subsequent to 1960.

Net income and earned surplus

For the year ended January 31, 1966, the addition to the reserve for the closing or sale of loss stores ($2,500,000) and the gain on sale of Lerner common stock ($219,441) included in the statement of consolidated earned surplus were set forth as special items following net income in reports filed with the Securities and Exchange Commission.

Other matters

There are several claims pending against McCrory and subsidiaries together with other contingencies (including long-term leases on locations at which operations have been or will be discontinued). Total liability cannot be determined but management and counsel are of the opinion that the liabilities in the consolidated financial statements are adequate to cover the same. At January 31, 1967 the minimum annual rentals upon property leased to McCrory and its subsidiaries under leases expiring after January 1970 amount to approximately $30,000,000 plus, in certain instances, real estate taxes, insurance, etc.

Events subsequent to January 31, 1967

On February 14, 1967 McCrory stockholders approved:

1. A recapitalization tender offer which expired April 10, 1967 under which McCrory accepted all securities tendered, consisting of approximately 522,600 shares of common stock, 41,800 shares of 4½% cumulative preference B stock, 1,800 shares of 5½% cumulative preference B stock and $1,243,000 principal amount of 5½% sinking fund subordinated debentures and issued in exchange therefor approximately $2,875,000 in cash and $11,992,000 principal amount of 6½% convertible subordinated debentures, due 1992.

2. An offer of $5,545,000 principal amount of McCrory 5% junior sinking fund subordinated debentures, due 1981 and 554,500 common stock purchase warrants, expiring March 15, 1981, in exchange for common stock and 5¾% convertible debentures of Klein.

3. A collateralized loan of $560,000 to McCrory's president, the proceeds of which were applied by him to the purchase of 80,000 shares of unissued common stock of Klein at a price of $7.47 per share.

BOARD OF DIRECTORS

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Bernard Kobrovsky
Stanley H. Kunsberg
*Harold M. Lane, Sr.
Harold M. Lane, Jr.
*Leonard C. Lane
Seymour Lazar
Samuel J. Levy
*Samuel Neaman
*Bert R. Prall
*Meshulam Riklis
*Julius Sanditen
*Leonard Spangenberg
Jerome D. Twomey
Harry H. Wachtel
Hugh C. Ward
J. S. Weinstein

* Member of Executive Committee.

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Executive Committee

Bernard Kobrovsky
Salary and Compensation Committee

Hugh C. Ward
Stock Option Committee

J. S. Weinstein
Acquisition and Diversification Committee

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Chairman of the Board

SAMUEL NEAMAN
President

ISIDORE A. BECKER
Vice Chairman & Treasurer

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Vice Chairman

HAROLD M. LANE, JR.
Executive Vice President

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Executive Vice President

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SAMUEL S. BRAND
Vice President

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Vice President

ELY SANDITEN
Vice President

SEYMOUR GREENE
Secretary

DIVISION AND AFFILIATED COMPANY PRESIDENTS

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McCrory-McLellan-Green Stores

Harold M. Lane, Jr.
Lerner Stores Corporation

Julius Sanditen
OTASCO-Economy Auto Stores

R. Duffy Lewis
S. Klein Department Stores, Inc.

Jack Schwadron
Best & Co.

Paul A. Johnston
Glen Alden Corporation

AUDITORS	Haskins & Sells, New York, N. Y.	
GENERAL COUNSEL	Rubin, Wachtel, Baum & Levin, New York, N. Y.	
TAX ADVISORS	Hanigsberg, Delson & Broser, New York, N. Y.	
PUBLIC RELATIONS	Rubenstein, Wolfson & Co., New York, N. Y.	
TRANSFER AGENTS	Common Stock 5½% Preference B Stock 4½% Preference B Stock	Chemical Bank New York Trust Company and First National Bank of Chicago
	3½% Preferred Stock $6 Preference Stock	Morgan Guaranty Trust Company of New York and First National Bank of Chicago
REGISTRARS	Common Stock 5½% Preference B Stock	Morgan Guaranty Trust Company of New York and Continental Illinois National Bank and Trust Company of Chicago
	4½% Preference B Stock	The Chase Manhattan Bank and Continental Illinois National Bank and Trust Company of Chicago
	3½% Preferred Stock $6 Preference Stock	Chemical Bank New York Trust Company and Continental Illinois National Bank and Trust Company of Chicago
EXECUTIVE OFFICES	711 Fifth Avenue, New York, N. Y. 10022	

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